

Message Text

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ACTION NEA-12

INFO OCT-01 ADP-00 AID-20 CIAE-00 COME-00 EB-11 FRB-02

INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12 CIEP-02

LAB-06 SIL-01 OMB-01 NSC-10 SS-15 STR-08 CEA-02 L-03

H-02 DODE-00 PA-03 USIA-12 PRS-01 RSR-01 /143 W

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R 261436 Z JUN 73

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC 8882

C O N F I D E N T I A L TEL AVIV 5032

E. O. 11652: GDS

TAGS: ECON, IS

SUBJECT: ISRAEL TRIES TO STEM THE TIDE OF INFLATION

REF: TEL AVIV 4955

1. SUMMARY. CABINET HAS AGREED ON IMMEDIATE THREE- MONTH FREEZE ON PRICES ONLY; WAGES ARE UNAFFECTED. DECISION HAS CLEARLY BEEN TAKEN WITH ONE EYE FIXED ON FORTHCOMING ELECTIONS. FREEZE MAY WELL APPEAR TO WORK FOR SUCH BRIEF PERIOD DUE TO SHOCK EFFECT AND SUMMER DECLINE IN FOOD AND CLOTHING PRICES. BUT, IT WAS SPECIFICALLY ACKNOWLEDGED THAT PRICE FREEZE COULD NOT WORK IN LONGER TERM. PRESUMABLY GOVT WILL USE NEXT THREE MONTHS TO TRY TO DEVELOP FOLLOW- ON MEASURES; EXPERIENCE OF LAST SIX MONTHS IS NOT ENCOURAGING IN THIS RESPECT, BUT ONCE PAST ELECTIONS GOVT WILL FEEL FREER TO ACT. TIDE OF PRICE RISES IS RUNNING SO STRONG THAT IT WILL TAKE MORE THAN COMMAND TO STOP IT. END SUMMARY.

2. CABINET DECIDED JUNE 24 TO FREEZE PRICES OF GOODS AND SOME SERVICES FOR PERIOD JUNE 25 THROUGH SEPTEMBER 30. SUBSIDIZED COMMODITY PRICES ARE TO BE MAINTAINED AT LEVELS FIXED IN APRIL (A-123). PRICES OF OTHER COMMODITIES ARE TO BE FROZEN AT LEVEL OBTAINING IN EARLY JUNE. THIS DECISION BEARS LOOK OF DEPERATION STOP- GAP, GOI NOT HAVING BEEN ABLE TO AGREE ON

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ANYTHING ELSE. BANK OF ISRAEL (BOI) GOVERNOR HAS BEEN ARGUING THAT THIS MOVE IS MEANINGLESS UNLESS FOLLOWED BY MEASURES TO REDUCE AGGREGATE DEMAND (SUCH AS REDUCTION IN GOVT SPENDING, AND INCREASE IN TAXES). DIRECTOR GENERAL OF GOI TOLD EMBOFF THAT PERIOD OF FREEZE WAS CUT FROM PREVIOUSLY MOOTED SIX MONTHS TO THREE

AS RESULT OF BOI'S INSISTENCE THAT PRICE FREEZE COULD NOT BE EFFECTIVE FOR LONGER PERIOD. DECISION ON FREEZING INTEREST RATES (REFTEL) POSTPONED UNTIL FINMINISTER SAPIR'S RETURN FROM OVERSEAS. BOI ARGUES THAT IF AGGREGATE DEMAND IS TO BE CUT, INTEREST RATES WILL HAVE TO RISE CERTAIN AMOUNT TO RATION CREDIT. BOI HAS BEEN ARGUING FOR INCREASE IN SUBSIDIZED INTEREST RATES FOR MONTHS, WITH SAPIR RESISTING.

3. PERIOD OF FREEZE IS OBVIOUSLY FIXED WITH ONE EYE ON ELECTIONS IN LATE OCTOBER/EARLY NOVEMBER. CONSUMER PRICE INDEX FOR SEPTEMBER WILL BE PUBLISHED OCTOBER 15, WHILE INDEX FOR OCTOBER ON NOVEMBER 15, I.E. AFTER ELECTIONS. THUS CONTROL OF PRICES THROUGH SEPTEMBER 30 SHOULD GET GOI PAST ELECTIONS, WHEN IT WILL FEEL FREER TO ACT.

4. PRICE FREEZE FOR NEXT THREE MONTHS MAY WELL WORK OR SEEM TO WORK, BECAUSE (A) OF SHOCK EFFECT OF FREEZE ON INFLATION PSYCHOLOGY; (B) DURATION IS SO SHORT THAT THERE WILL LIKELY BE BROAD WILLINGNESS TO WAIT UNTIL IT IS OVER BEFORE RAISING PRICES; (C) SEASONAL FACTORS (GREATER AVAILABILITY OF FOOD AND SLACK BUYING OF CLOTHING) TEND TO SLOW INFLATION DURING SUMMER ANYWAY.

5. FREEZE DOES NOT SOLVE GOI'S PROBLEM OF WHAT TO DO ABOUT CONTAINING INFLATIONARY PRESSURES; AT BEST IT MAY OFFER BRIEF RESPITE TO THRASH OUT POLICY. HOWEVER, INABILITY OF GOI TO AGREE ON EFFECTIVE POLICY DURING PAST SIX MONTHS IS NOT ENCOURAGING IN THIS RESPECT. GOI WISHES TO REDUCE INFLATION TO TOLERABLE LEVEL OF SAY 8-9 PERCENT ANNUALLY, BUT WITHOUT RISK OF OVERCORRECTING AND PRECIPITATING RECESSION. (AS HAPPENED IN 1965). THEREFORE ONLY SMALL STEPS ARE ACCEPTABLE. SMALL STEPS AUTHORIZED HERETOFORE HAVE HAD NO APPARENT IMPACT ON INFLATIONARY PRESSURES. GOI IS INHIBITED FROM TAKING LARGER STEPS NOT ONLY BY FEAR OF CAUSING RECESSION BUT BY IMMINENCE OF ELECTIONS; BUT ISRAEL CANNOT POSTPONE DECISION INDEFINITELY.

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6. IF GOI CAN PULL OFF FINE-TUNING OF ISRAELI ECONOMY IN FACE OF DIFFICULTIES CITED ABOVE, IT WILL HAVE ACCOMPLISHED NOTABLE FEAT, WHICH EVEN COUNTRIES WITH GREATER EXPERIENCE WITH BUSINESS CYCLE HAVE ONLY SOMETIMES ACHIEVED. HOWEVER, TIDE OF INFLATION IS RUNNING SO STRONGLY THAT IT WILL TAKE MORE THAN COMMAND TO STOP IT.

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